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Acquisition of Plus Discount by Jerónimo Martins

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ABSTRACT

On the 21st of December 2007, Jerónimo Martins announced that it was acquiring the Plus Discount chain of stores in Poland and in Portugal. This was an excellent opportunity to strengthen even more the leading position of Jerónimo Martins in the hard discount sector of the Polish retail market, through the chain Biedronka.

This case study will analyze the main motives for this acquisition and contextualize it in the strategy of Jerónimo Martins for Poland. The main elements of the valuation of the chain Plus Discount will also be discussed throughout the case.

Keywords: acquisition, valuation, strategy.

Introduction

On the 2nd of December 2007, the CEO of Jerónimo Martins, Luís Palha da Silva, was returning to Portugal with a lot to reflect. A company Board meeting had been scheduled for the following day, and the final decision for the acquisition of the chain of stores Plus Discount had to be presented.

The take off from the Warsaw Frederic Chopin airport in Poland, concluded Luís Palha da Silva's one week visit of the operations of Jerónimo Martins in that country, where he could once again witness the success of the chain Biedronka. During the flight to Lisbon he wondered if the acquisition of the 210 stores of Plus Discount in Poland was the right move, given that the leadership of Biedronka in the Polish retail market was supported by an impressive growth of stores made exclusively through organic growth. Moreover, he was considering if this acquisition might not be as profitable as having launched the stores from scratch, and also if the integration process could be done in an effective way. However, all these stores could end up in the hands of one of the direct competitors of the firm.

Besides this dilemma there was also the issue of the price to offer for the whole chain. It had to be higher than what was being offered by the other firms interested in the deal and also enough to please the owners of Plus Discount, but it could not be excessive, in order to render the operation profitable. Bearing that in mind, he knew that some difficult issues of the valuation, such as the total synergies, the number of years before the Plus stores would reach the operational level of Biedronka and the costs of restructuring, had to be taken into account.

Jerónimo Martins

The history of Jerónimo Martins goes back to the distant year of 1792, when a young Galician, hoping for better days, came to Lisbon and opened a small and modest gourmet shop in Chiado. A few years later, the store had become a great success, supplying many embassies, ships and even the Portuguese Royal House.

Although Jerónimo Martins had started out as a simple store that just sold sacks of wheat and corn, sausages, bottles of wine and many other ordinary products, by the end of 2007 it had become one of the most important Portuguese retailers, achieving only in this year total sales of over 5.3 billion Euros. During this period it had expanded its activities not only into other areas, but also into other countries, particularly to Brazil, the United Kingdom and mainly Poland, always maintaining its core business as food, as is portrayed in its mission statement: "We know about food".

At the end of 2007 Jerónimo Martins had diversified its activities in Portugal within three major areas: distribution, manufacturing and services (Exhibit 1), the first area representing 95% of total sales. In this area it has three different chains, Pingo Doce, Feira Nova and Recheio. The first one operates in the food retail sector through the format of supermarket and is the leader with 1.136 million Euros in 2007, ahead of Continente with 1.133 million Euros. The second one is in the same sector, but through mini-hyper and hypermarkets, and occupies the third place following the two chains mentioned above with 800 million Euros in sales. The last one is a wholesale distribution company that operates under the cash & carry format, being the leader of its kind with sales of 626 million Euros.

In the manufacturing sector Jerónimo Martins has a joint-venture with Unilever, which allows them to have the biggest Portuguese industrial group in fast moving consumer goods and leadership brands in diverse markets like oil, margarine, ice tea and others. Through the services sector Jerónimo Martins owns the Hussel retail chain of chocolates and is responsible for representing other international companies in the food and cosmetic areas in Portugal.

International expansion

In 1995, Jerónimo Martins decided to expand its operation to Poland. The desire for internationalization was explained by the feeling that Portugal was not enough for the wishes and plans of expansion that the owners had for the firm. The choice for this country is justified by several different facts. The first one is its size. Poland, with a population of 38 million, was the 8th biggest country in Europe and the 3rd in Eastern Europe, only surpassed by Russia and the Ukraine. Furthermore, the future expectations for this country were also very important. There were great perspectives of future economic development and it was only a few years away from becoming a member of the European Union.

Another decisive factor for the decision to move to Poland was the appearance of a specific opportunity worth pursuing. This opportunity arose from a contact through a Polish businessman that was the owner of a chain of cash & carry, Eurocash. This format being particularly well known to Jerónimo Martins, constituted an even greater incentive to really pursue the expansion to this country. Consequently, together with an English company named Booker, with which Jerónimo Martins already had a partnership for some years, the company moved ahead to the acquisition of Eurocash.

Following this investment, in 1997 Jerónimo Martins decided to make a new acquisition once again through the same Polish contact. This time it was the company Biedronka, which operated in the format of discount through 243 stores. An investment of this magnitude reflected the company's determination and confidence in the success of the Polish operations. In the following three years Biedronka opened more than 300 stores in Poland. Once again this operation was made through a partnership, only this time with a Polish group that became responsible for choosing the locations of the stores, building them and then starting the operations.

One year after the acquisition of Biedronka, Jerónimo Martins launched the first hyper market Jumbo in Poland, allowing the company to operate simultaneously in three different formats just a few years after starting the operations in Poland.

During that period the company also expanded its operations to other countries. In 1996 it acquired the British chain of sports Lillywhites that was the property of the Queen of England and in 1997 the Brazilian supermarkets Sé (exhibit 2). This was a period of great success for Jerónimo Martins, the value of their stock was rising very quickly and the atmosphere felt in the firm at the time was one of great euphoria related to this international expansion. Even the banks were approaching the company offering to finance any projects that they might have.

Restructuring

However, despite the impressive international expansion and the very optimistic scenario, things gradually started to become more difficult. Not only the lack of knowledge about the Polish market, but also of the discount format, was making the expansion much harder than what had been anticipated. Adding to that was the inaccuracy in the forecasts on the level of competition. In fact, between 1995 and 2000 almost all of the main international operators of this type of market entered Poland (exhibit 3). All this led to the failure of the first estimates, which were considered to be very optimistic given the real conditions.

Following the first difficulties in Poland, things got worse at the beginning of the new millennium. The global crisis that was happening at that time was creating adversities for every operation of Jerónimo Martins. The first symptom was the drop in the profitability in the activities of the firm, which was reflected in problems of liquidity and also in the value of its stock. During that period the Group faced serious financial problems not only caused by the global crisis and specific problems in each country, but also by a very rapid international expansion for which the company did not seem to be prepared, at least in financial terms. This situation culminated in the inability of the firm to pay the interest on its debt.

Facing these problems, Jerónimo Martins decided to go ahead with an issue of stock of 300 million Euros, together with the restructuring of the firm. The objective of this restructuring was to alienate the non-profitable areas, in order to obtain some needed funds for the company and mainly to allow it to concentrate on its core areas. In 2001 some Portuguese operations owned by Jerónimo Martins i.e. Vidago, Melgaço and Pedras Salgadas were sold to Unicer, and in 2002 it was the British company Lillywhites that was sold to Sports Soccer.

Nonetheless, the cash received was not enough to solve all the problems and therefore, there was the need to move for the alienation of some of the core assets. So, that same year it sold the Sé supermarkets in Brazil and the Jumbo hypermarkets in Poland, and in 2004 the firm Eurocash was sold. All these firms had not achieved the expected results, however due to the fact that they were still in a launching phase, there was still the possibility of them becoming a success.

Once the process of restructuring had been concluded, everyone at Jerónimo Martins felt that this had not only been necessary, but also extremely useful. It allowed the company to reduce its debt significantly, to return to profitability and mainly to focus exclusively on its core business again, maintaining only one international business unit, which was Biedronka.

Biedronka

Biedronka is a chain of retail stores, owned by Jerónimo Martins, that operates under the discount format, which means the practice of lower prices than those in the traditional retail stores.

During the difficult period that Jerónimo Martins went through from 1999 until 2003, this was the unit that had managed to grow and expand its activities successfully. Since the acquisition in 1997, Biedronka had achieved the leading position in the hard discount sector of the Polish retail market, holding about two thirds of this sector.

One of the fundamental aspects for this leadership was the impressive pace in opening new stores. By 2001 it had opened 620 stores and by the end of 2004 it already had more than 700. In exhibit 4 we can see the number of stores opened each year and in exhibit 5 the number of stores of the direct competitors by the end of 2007. This bet on a high number of stores is one of the main features of the strategy of Biedronka. This is considered to be an important advantage against the competition, since a larger number of stores will imply higher economies of scale and bigger volumes of goods ordered from the suppliers, which consequently will provide the firm with lower prices. In this manner Biedronka is capable of practicing lower prices against competition. Its importance is also reflected in a higher proximity to the clients that not only offers the consumer quicker access to the stores, but also works as publicity.

The strategy of communication was also important. Biedronka developed a very effective communication with the consumers, aptly conveying the message of the low prices. The firm has developed the slogan *"Everyday low prices"* and other publicity campaigns that have received important Polish brand awards. Their success is expressed in the fact that Biedronka has a substantial lead in terms of brand awareness over the competition. Another important aspect of the strategy is the concern with the level of operating efficiency, which is fundamental for controlling the costs of the operations.

At the end of 2007, not only has the company been able to maintain a leading position in the hard discount sector of the Polish market, but has also strengthened it. The number of stores increased to 1.045, with sales of 2.392 million Euros, which represented an increase of 35% over the last year of 2006 (Exhibit 6). Furthermore, over the last years the Jerónimo Martins distribution in Poland has increased its weight within the whole group. As we can see in the exhibits 7, 8 and 9, since 2003 Biedronka has increased its sales strongly, achieving in 2007 44.7% of total sales and 46.85% of total employees. Over the years the portfolio of sales has been comprised of about 80% of food products.

A new opportunity for acquisition

In the second semester of 2007 an opportunity for acquisition appeared for Biedronka. This possibility was related to the potential sale of the chain of stores Plus discount, which was a direct competitor in the hard discount sector.

This was in fact a revival of the interest of Jerónimo Martins in Plus Discount that dated back to 2003. By this time Biedronka was facing problems with getting new licenses for its new stores, due to limitations imposed by the Ministry of Interior in granting these licenses to foreign firms. Facing this problem, Jerónimo Martins decided to follow the activities of companies like Plus Discount, Lidl and Leader Price in Poland more closely, and considered a possible acquisition that could allow Biedronka to continue its expansion. However, in 2004 with the entrance of Poland in the European Union the limitations imposed by the Ministry had to be lifted, and consequently the interest in an acquisition decreased.

This interest was suddenly revived when in the second semester of 2007 some rumours started to circulate, saying that the Plus Discount operations owned by the German company Tengelmann were for sale in countries such as Hungary, the Czech Republic, Spain and Poland. These rumours were later confirmed when Plus was sold to Carrefour in Spain in July 2007, and also when some banks approached Jerónimo Martins with the information that Tengelmann was interested in selling their operations in Poland. This interest was justified by two reasons, the first was the change of focus in their core business to real-estate, and the second was related to the low success of the brand Plus in the Polish market, caused by their inability to achieve a high scale of efficiency that could allow them to compete with the other discount brands such as Biedronka, Lidl and Netto.

Plus Discount

Plus Discount is a chain owned by the German company Tengelmann, which is the fourth largest retail supermarket and distribution group in the world. With 7.700 stores that range from hypermarkets to discount markets and drugstores, this company has spread all over Europe in countries such as Germany, Austria, the Netherlands, France and Poland, and to the United States and Canada. Tengelmann is the owner of many brands i.e. Plus, A&P, OBI, Kik and Kaiser.

The chain of stores Plus, due to its discount format, is a direct competitor of Biedronka in the hard discount sector. By the end of 2007 it had stores in seven different European countries, including Portugal and Poland. It entered the Polish market in 1996 and in the end of 2007 it had 210 stores, with 435.6 million Euros in sales. In exhibit 10 more detailed information about the operations of Plus at the end of 2007 can be found.

Macroeconomic context in Poland

At the end of 2007 Poland was one of the fastest growing economies in Europe. In the last two years it had been able to reduce the gap between the European Union and the OECD countries. By registering a growth above 6% in this period, Poland had reached the best economic performance since the late 1990s and also the second best performance in the OECD. The main reasons for this growth are the very significant rise in the expenditures made by the Polish consumers and also the increase in the level of the investments. The first one can be explained by the increasing employment, wages and remittances of emigrants, and the second by the infusion of direct foreign investment and of European structural funds that have been used to co-finance public and private investments.

This strong economic growth has been fundamental to gradually improve the general level of live of the Polish population. In 1995 when Jerónimo Martins began its investment in this country, most of the population had low wages, lived in small houses and did not have enough income to afford goods beyond the ones of first need. For example, the number of cars at that time was very small. Nevertheless, with the economic development these indicators have been progressively improving.

In 2007 the behaviour of the inflation suffered a change. As opposed to recent years where inflation had recorded low values, in the present year and for the next years it is expected to suffer a relevant increase. This is due essentially to the food and energy shocks, and the economy's growth. The average value of the Zloty in 2007 was 0.28 Euros, which corresponds to an appreciation of 5.8%. Current expectations point for further appreciation of the Polish currency.

In Exhibit 11 we can find relevant data related to Polish economic aspects, mainly the values of the GDP, of inflation and of net exports.

Retail Food Market – Poland

The Polish retail food market is considered to be the most interesting in Central and Eastern Europe for many years in the future, as companies can take advantage of the economic development and of the political stability. In 2007 the retail food market in Poland showed strong signs of development again, achieving a growth in the order of the two digits, surpassing 220 billion zlotys. This is a trend that has been increasing rapidly in the last fifteen years, together with the overall tendency of the economy.

One very characteristic point of the Polish retail food market is its high degree of competition, expressed in a high number of companies present in this market, mainly international operations. The number of firms present is one of the highest in Europe, which implicates a very aggressive and competitive environment and also a great pressure on the prices. As we can see in exhibit 12, the market is very fragmented, having ten top retailers that own approximately 92% of the total market. As a result of this, there is an intensive movement of consolidation. For example, in 2007 there were various consolidating actions in the small domestic retail chains, with the acquisition of some regional chains by the Emperia Group, which is a Polish retail and wholesale company. In the previous year, the firms Julius Meinl, Casino and Ahold, sold their operations in Poland to Tesco, Metro and Carrefour respectively.

Another important feature is the role of the organic growth, which every company considers to be one of its priorities. This is confirmed by the high number of new stores opened in the last years. In 2005 it is estimated that 250 new stores were opened, in 2006 they were more than 250 and in 2007 more than 200 just in the discount format.

If we look at exhibit 13, we can conclude that the market is divided almost perfectly among the three main types of format, hypermarkets holding the biggest share, followed by the discount and the supermarkets. A different format that has a small part compared to the last three is the cash & carry.

Observing the tables of exhibits 14 and 15, we can see the ten most important food retailers in Poland, which correspond to the main competitors of Jerónimo Martins. First we can highlight the company Lidl & Schwarz, which is the second player in terms of sales in the discount format, the same as Biedronka. Not mentioned in the table, but also operating in this format is the firm Netto that is smaller than both Biedronka and Lidl. In the beginning of 2008 the German group Aldi is also expected to enter into this segment. Outside the discount format we can highlight some important companies like

Metro, Spolem and Tesco. Metro is a German company that has its third most important international market in Poland. Spolem is a Polish group that works as a cooperative network of more than 4000 independent stores of different sizes, but predominantly supermarkets. Tesco is the largest British retailer and the leading operator in the Polish hypermarket sector.

To finalize, it is important to mention that the referred companies have been increasing their operations using a mixture between organic growth and consolidation, which has been able to give the firms a fast increase in the total number of stores throughout Poland.

The Deal

Jerónimo Martins decided to show interest in a possible acquisition of Plus Discount and started conversations with the banks that had approached them offering this possibility. The information that the banks had to give was just a teaser to notify the intention of Tengelmann and what assets it wanted to sell, the financial information that it contained was much reduced. Despite that, the company decided to go ahead and signed a non-disclosure agreement in order to receive more detailed financial information about Plus.

After looking carefully at this new data, Jerónimo Martins took some time to decide if they really would like to proceed, since the next phase would imply high costs with teams of auditors and lawyers. Bearing that in mind, it carefully analyzed both the financial information and the location of the stores. For this last type of analysis, it was important to check each store individually in order to assess its potential, because in this type of acquisition a company is essentially buying the location of the stores. So, every factor that might influence this, such as the amount of people living in the surroundings, the traffic passing by, if it is located in an urban center, the accessibility, the existence of a parking lot and the proximity to existent stores of Biedronka had to be taken into account.

After making the evaluation, the managers of Jerónimo Martins concluded that although not all of the stores had great potential, they were good enough to advance with a non-binding offer. This offer was accepted by Tengelmann and now a binding-offer had to be prepared. By this time there were other companies interested in the acquisition, however Jerónimo Martins did not know who or how many they were.

To create the binding-offer all the firms had access to a data-room, where further confidential information about Plus Discount was available. Jerónimo Martins assembled a team that had people from the firm, together with auditors and lawyers to check every bit of information that was accumulated in several piles in the room. The objective of the team was to verify if this new information would affect the valuation made for the previous offer, for example, they might find contracts that could impose a payment of a significant amount in the future, or a lawsuit that might imply a positive cash-flow. Therefore, the binding-offer could have a positive or negative correction relatively to the non-binding, depending on the information analyzed in the data-room.

After the acquisition

On the 21st of December of 2007 Jerónimo Martins announced the acquisition of the Plus Discount chain of stores, not only in Poland but also in Portugal, paying a total of 320 million Euros. In Poland the Plus stores were integrated into the Biedronka chain and in Portugal into Pingo Doce. In exhibit 16 the effect of the acquisition in the market shares in the Polish hard discount sector is portrayed.

At that time the reaction of the analysts was very positive, for example, the BPI equity research said: *"… Overall, we are confident that this acquisition will create value for JMAR and reinforce our positive stance on the stock… this acquisition will allow JMAR* *to eliminate one of its main competitors (especially in Poland), increasing the consolidation level of both retail markets…we believe this move will create a significant amount of synergies in both countries, especially in terms of procurement, logistics and marketing…"*. A comment was added that the price paid for the operation was reasonable.

However, during the following year the macroeconomic context changed completely. The economic crisis initiated in the financial markets was responsible for the contraction of the economies all around the World, and modified the expectations for the macroeconomic figures. Comparing exhibit 12 with 17, we can observe the changes in the forecasts for the Polish GDP and for the values of inflation. The projection for the GDP was revised in a very negative way, and despite the economic growth being positive, it is expected that it will suffer a significant slowdown. As a result the value of the inflation is also expected to decrease, and the high values predicted at the end of 2007 for the following years are now much lower.

This change in the macroeconomic context may affect the value given to Plus Discount at the end of 2007. Some of the assumptions made when the valuation was first done, are now completely inaccurate, consequently it is expected that if the valuation is made with the macroeconomic conditions of the beginning of 2009, the value of the firm will not be the same.

Exhibits

Exhibit 1 – Areas of Jerónimo Martins

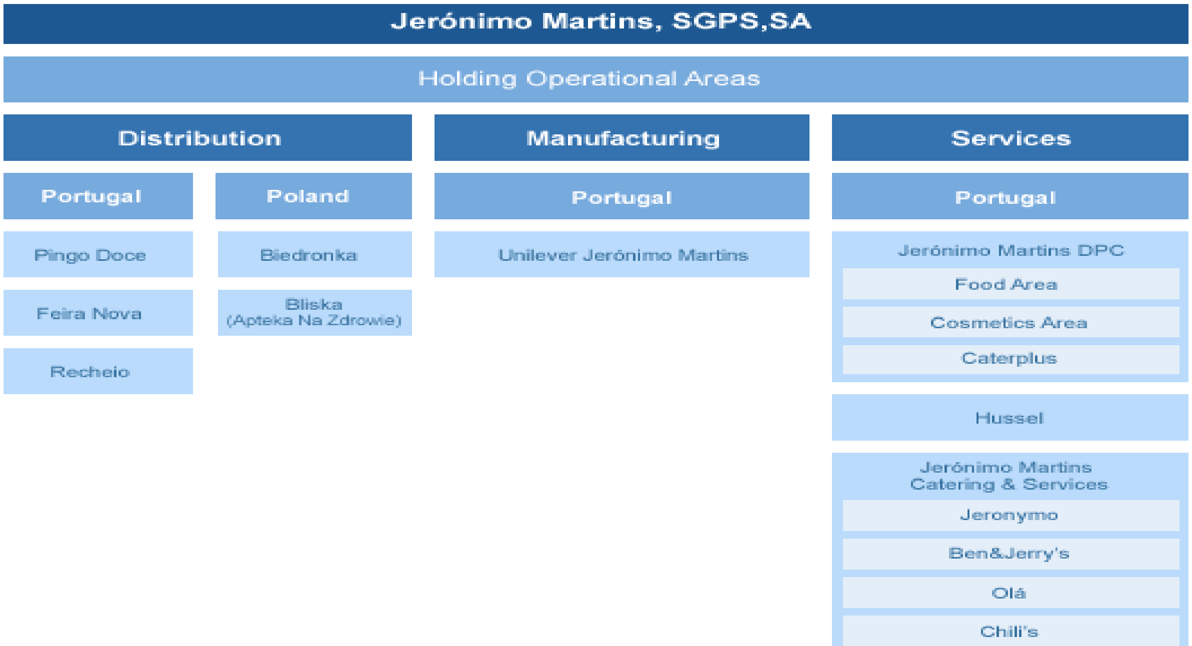


Exhibit 2 – Timeline with foreign investment of Jerónimo Martins

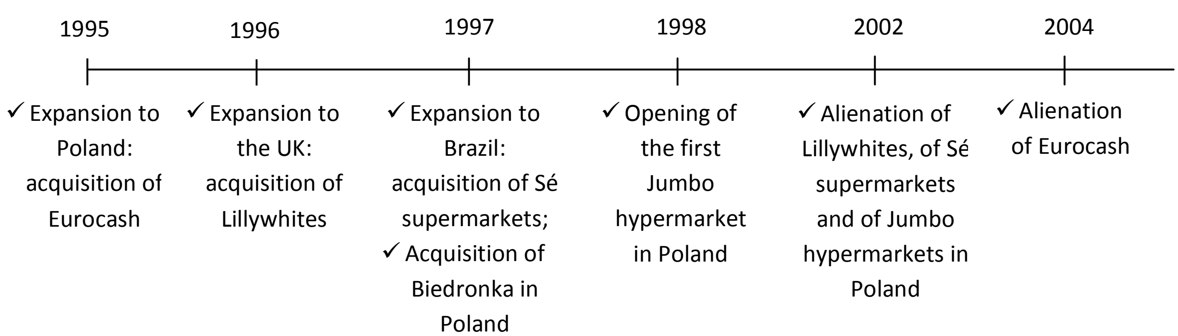


Exhibit 3 – Entry years of the companies in the Polish retail market

Year of entry	1992	1993	1994	1995	1996	1997	1998	2000	2001	2002
Company	Billa	Makro	Hit Globi	J. Martins Savia Geant Leclerc	Plus Real Jumbo Auchan	Carrefour Hypernova Intermarché	Tesco	Leader price Champion	Kaukland	Lidl

Exhibit 4 – Number of stores of Biedronka

Years	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Nº Stores	243	373	579	592	621	638	672	725	805	905	1.045
Variation	243	130	206	13	29	17	34	53	80	100	140

Source: Biedronka

Exhibit 5 – Number of stores of the direct competitors of Biedronka in the hard discount sector in the end of 2007

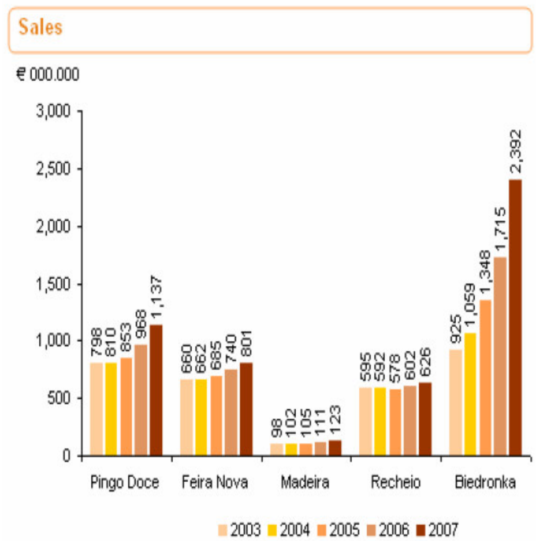
Company	Netto	Plus Discount	Lidl
Nº of stores	136	210	281

Exhibit 6 – Economic and financial indicators of Biedronka

Biedronka	1st Semester			2nd Semester		
PLN'000	**2007**	**2006**	**Δ %**	**2007**	**2006**	**Δ %**
Number of Stores	962	834		1.045	905	
New	64	36		156	116	
Closed	7	7		16	16	
Remodeled	25	30		71	57	
Sales Area	486.487	412.042	18,1%	536.729	452.952	18,5%
Weighted Sales Area	464.886	399.352	16,4%	482.455	411.723	17,2%
Store Sales	4.065.427	3.068.622	32,5%	8.969.377	6.638.213	35,1%
Sales / sqm	8,75	7,68	13,8%	18,59	16,12	15,3%
Sales Like for Like			19,2%			21,1%

Source: Biedronka

Exhibit 7 – Growth of the sales and sales per sqm of the business units of Jerónimo Martins



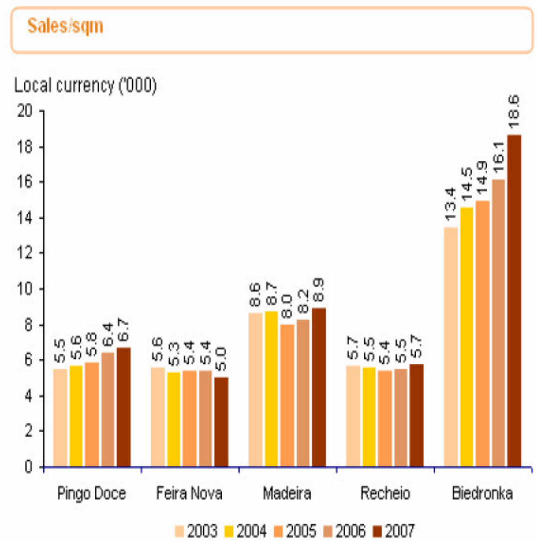
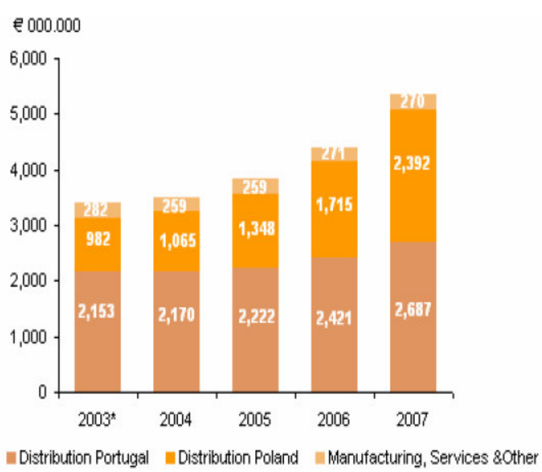


Exhibit 8 – Nº of stores and sales area

Number of Stores and Sales Area

	2007	2006	2005	2004	2003
Pingo Doce	210	189	179	178	177
sqm	183,770	161,279	149,158	146,089	145,869
Feira Nova	46	38	29	28	25
sqm	172,039	150,189	130,684	128,317	122,907
Madeira	15	15	15	14	15
sqm	14,626	13,697	13,697	11,982	11,463
Recheio	33	33	32	32	31
sqm	109,634	110,005	107,202	107,202	104,524
Biedronka	1,045	905	805	725	672
sqm	536,729	452,952	394,536	348,751	317,942

Exhibit 9 – Sales of the sectors of Jerónimo Martins



* Include sales from disposed business areas

€ 000.000	2007	2006	Δ %
Distribution Portugal	2,687	2,421	11.0%
Distribution Poland	2,392	1,715	39.5%
Manufacturing, Services & Others	270	271	-0.3%
Consolidated Sales	**5,350**	**4,407**	21.4%

Exhibit 10 – Plus Discount information

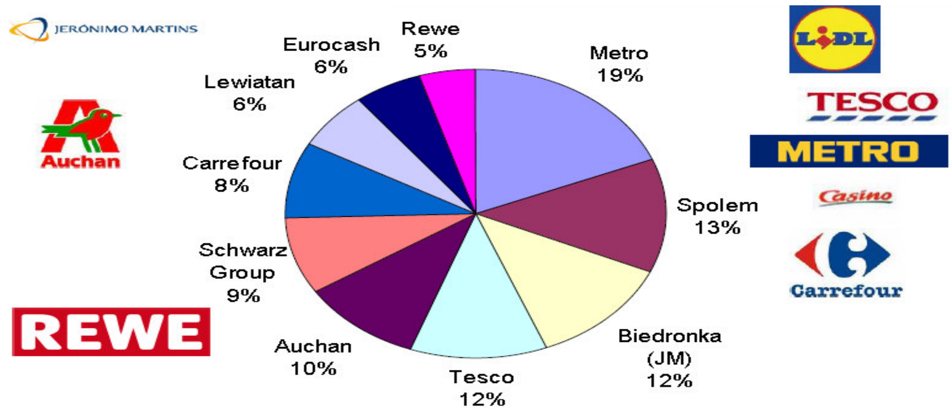
Country	Gross sales			Stores		Employees	
	Million EUR	Δ In % to previous year	Δ In % to previous year currency-adjusted comparison	Actual total	Δ In % to previous year	Actual total	Δ In % to previous year
Germany	7,059.5	2.7	2.7	2.766	-5.0	27,011	-1.1
– of which Plus Online	62.8	4.9	4.9	-	-	51	18.6
Austria	658.3	2.7	2.7	364	0.8	3,235	-2.4
Poland	435.6	15.2	8.5	209	1.5	2,658	6.5
Romania	254.7	101.3	99.9	53	35.9	1,383	44.1
Czech Republic	517.9	15.5	10.3	149	12.0	2,161	-1.1
Hungary	452.6	12.4	8.9	175	4.2	2,206	-3.9
Subtotal	**9,378.6**	**5.8**	**5.1**	**3,716**	**-2.7**	**38,654**	**0.2**
Spain (until 11/07)	277.9	n/a	n/a	0	-100.0	0	-100.0
Greece (until 03/08)	90.5	n/a	n/a	0	-100.0	0	-100.0
Portugal	196.8	17.9	17.9	0	-100.0	0	-100.0
Total	**9,943.8**	**3.9**	**3.3**	**3,716**	**n/a**	**38,654**	**n/a**

Exhibit 11 – Poland Macroeconomic data

Poland	2004	2005	2006	2007	2008	2009
Gross domestic product - volume - market prices	5,3	3,6	6,2	6,5	5,6	5,2
Private final consumption expenditure - volume	4,7	2,1	5,0	6,1	6,2	6,1
Government final consumption expenditure - volume	3,1	5,2	6,1	1,5	1,9	2,0
Exports of goods and services - volume	14,0	7,9	14,6	8,9	8,3	8,6
Imports of goods and services - volume	15,7	4,7	17,4	13,5	12,3	11,5
Unemployment rate - as a percentage of labor force	19,0	17,7	13,8	9,6	8,4	7,7
General government financial balance - as a percentage of GDP	-5,7	-4,3	-3,8	-2,0	-3,2	-3,0
Consumer price index	3,4	2,2	1,3	2,5	3,6	4,2

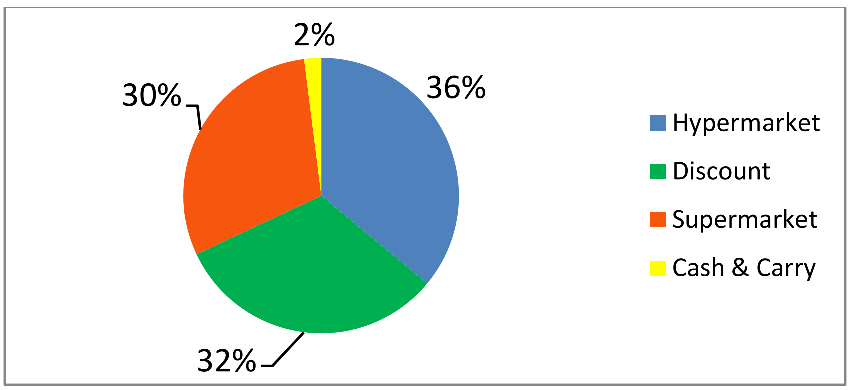
Source: OECD

Exhibit 12 – Market share of each company in Polish retail market



Source: IGD

Exhibit 13 – Retail market by type



Source: IGD

Exhibit 14 – Top 10 Retailers 2006

Top 10 Retailers 2006

Retailer	Total Sales (€m)	Grocery Sales (€m)	% Change Grocery Sales (06 vs 05)	Grocery Market Share (%)	No. of Grocery Stores	Sales Area (sqm)
Metro	3,447	2,687	+9.4%	6.6%	74	416,751
Spolem*	1,807	1,807	+2.2%	4.5%	>4,000	800,000
Jerónimo Martins	1,715	1,715	+27.2%	4.2%	905	452,952
Tesco	1,583	1,583	+18.4%	3.9%	144	435,251
Auchan	1,475	1,440	+3.51%	3.6%	34	314,000
Carrefour	1,430	1,430	+39.2%	3.5%	114	432,000
Lidl & Schwarz	1,250	1,250	+54.3%	3.1%	220	356,000
Rewe	661	661	+17.0%	1.6%	35	70,000
Lederc	525	520	+12.2%	1.3%	19	83,900
Eurocash	507	507	+15.5%	1.3%	>2,600	644,000
Lewiatan	500	500	+4.2%	1.2%	>1,300	260,000

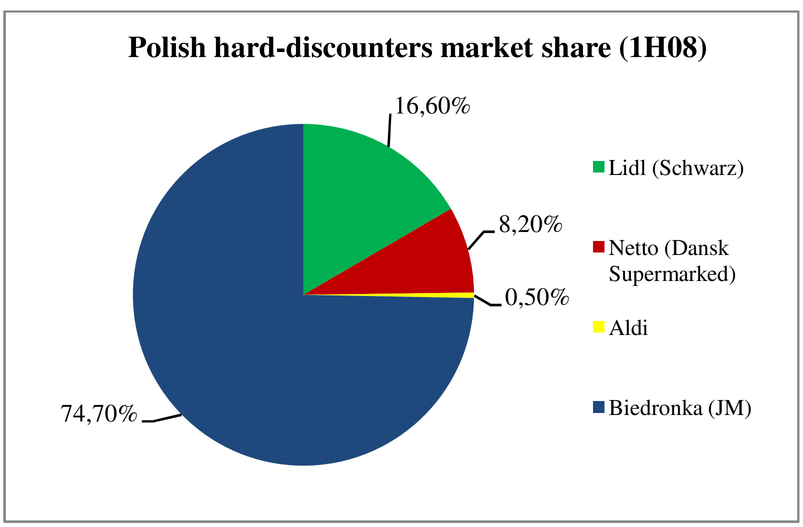
*Spolem operates as a cooperative network made up of over 4,000 independent stores.

Source: IGD datacentre estimates, 2006

Exhibit 15 – Companies and their respective brands in the Polish retail market

Company	Brand	Format
Metro	Makro	Cash & Carry
Metro	Real	Hypermarket
Spolem	Spolem	Supermarket
J. Martins	Biedronka	Discount
Tesco	Tesco	Hypermarket
Tesco	Savia	Supermarket
Auchan	Auchan	Hypermarket
Auchan	Elea	Supermarket
Carrefour	Carrefour	Hypermarket
Carrefour	Champion	Supermarket
Lidl & Schwarz	Lidl	Discount
Rewe	Billa	Supermarket
Leclerc	Leclerc	Hypermarket
Eurocash	Eurocash	Cash & Carry
Lewiatan	Lewiatan	Supermarket

Exhibit 16 – Effect of the acquisition of Plus by Biedronka



Source: BPI equity research

Exhibit 17 – Macroeconomic data for Poland in the end of 2008

Poland	2007	2008	2009	2010
Gross domestic product - volume - market prices	6,7	5,4	3,0	3,5
Private final consumption expenditure - volume	5,0	4,9	3,9	4,1
Government final consumption expenditure - volume	3,7	0,1	1,8	2,0
Exports of goods and services - volume	9,1	6,5	1,3	1,9
Imports of goods and services - volume	13,5	6,8	3,6	2,1
Unemployment rate - as a percentage of labor force	9,6	7,2	7,1	7,6
General government financial balance - as a percentage of GDP	-2,0	-2,3	-2,7	-2,9
Short-term interest rate - per cent, per annum	4,8	6,4	6,6	6,6
Consumer price index	2,5	4,2	3,2	3,6

Source: OECD

Exhibit 18 – Elements of the valuation

The acquisition of Plus Discount in Poland would imply the sum of 210 stores with an average size of 700 square meters. However, it is expected that the Polish authority of competition imposes some limitations to this operation, thus it is estimated that the firm will have to dispose 25 of the Plus stores and also 15 of the current chain of Biedronka. This disposal will in turn provide approximately 15 million Euros. It is also important to notice that the stores will only be fully operative in the beginning of 2009, so it will not produce any income for Biedronka during 2008.

Furthermore, the managers of Jerónimo Martins expect that the stores acquired will be able to achieve the operational level of Biedronka in no more than 3 years. This means that in this period the stores acquired will gradually increase their level of sales per sqm and their margins until they are the same as the stores of Biedronka. In exhibit 20 we can find the expectations about the rates of growth of these two indicators. The terminal growth of the free cash-flow of each store is expected to be 0.5% above inflation, which is estimated around 2%. The value of depreciation will be assumed to be 2% of total sales every year, and the taxes will remain constant at 19%.

For the capital expenditures there are three different aspects. The first one is the capital spent on the restructuring of the Plus stores into Biedronka, which is 600 thousand zlotys for each one. The second aspect is the 2 million zlotys per store necessary to do the revamping in every 7 years. The final element of the capex is the annual capital expenses necessary to maintain the capacity of the stores that are 600 thousand zlotys per year. The values of the changes in the net working capital for the Plus stores are shown in exhibit 21.

The synergies of this operation can be calculated by comparing the effect on the margins with and without the Plus stores. We have to do this only for the years of 2009 and 2010, since Jerónimo Martins expects that from 2011 the EBITDA margin will remain 6.5% forever. So by making the difference between the free cash-flow of the 1100 stores, which is the number of stores expected to exist in the beginning of 2009, with and without Plus, we get the value of synergies. In exhibit 22 the differences between the margins are presented.

Another important element of the valuation is the loss of the 15 Biedronka stores, since it represents the loss of the respective free cash-flow provided by them. For these stores the capital expenditures with the revamping and for maintaining the capacity of the stores is the same, but the changes in the net working capital are different (exhibit 23).

Finally, there are two more elements that should be considered, the first one is the costs of non-recurrent nature of the acquisition of 10 million Euros, and the second is the 1 million Euros for possible contingencies that may come up, like for example unexpected debts of the Plus stores, which should also be taken into account.

Exhibit 19 – Elements of the valuation for 2009

Despite the drastic change in the macroeconomic context, there are not expected significant changes in the rates of growth of the sales per square meter and of the EBITDA margins. In the exhibits 24 and 25 we can find the differences. All other elements, with the exception of the discount rate and of the spot exchange rate, remain the same as in the end of 2007.

Exhibit 20 - Sales per sqm & EBITDA margins

Sales per sqm (zloty)	2003	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	13.400	14.500	14.900	16.100	18.600	21.204	22.688	24.276	25.733	27.020	28.100	29.225	30.393	31.609	32.399
Variation	-	8,21%	2,76%	8,05%	15,53%	14,00%	7,00%	7,00%	6,00%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%
Plus	12.817	13.252	12.173	10.348	10.926	-	15.898	21.462	25.733	27.020	28.100	29.224	30.393	31.609	32.399
Variation	-	3,40%	-8,15%	-14,99%	5,59%	-	45,50%	35,00%	19,90%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%

EBITDA Margin	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	4,90%	5,10%	5,35%	5,90%	6,10%	7,00%	6,80%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%
Plus	-	-	-	-	-	4,50%	5,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%

Exhibit 21 – Changes in NWC Plus stores (zlotys)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Changes in NWC	-400.000	-300.000	-160.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000

Exhibit 22 - Synergies

With Plus	2009E	2010E
Sales per sqm	22.688	24.276
EBITDA margin	7,00%	6,80%

Without Plus	2009E	2010E
Sales per sqm	22.688	24.276
EBITDA margin	6,25%	6,35%

Exhibit 23 – Changes in NWC Biedronka stores (zlotys)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Changes in NWC	-80.000	-80.000	-65.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000

Exhibit 24 – Sales per sqm and EBITDA margins 2009

Sales per sqm (Zloty)	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	20.800	22.256	23.814	25.243	26.505	27.565	28.668	29.814	31.007	31.782
Variation	12,00%	7,00%	7,00%	6,00%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%
Plus	-	15.297	21.110	25.243	26.505	27.565	28.668	29.814	31.007	31.782
Variation	-	40,00%	38,00%	19,58%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%

EBITDA margin estimatives	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	6,10%	7,00%	6,80%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%
Plus	-	4,50%	5,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%

Exhibit 25 – Synergies 2009

With Plus	2009E	2010E
Sales per sqm	22.256	23.814
EBITDA margin	7,00%	6,80%

Without Plus	2009E	2010E
Sales per sqm	22.256	23.814
EBITDA margin	6,25%	6,35%

Exhibit 26 – Elements for the computation of the discount rate

	Risk-free	Return of the market	Cost of debt	Debt	Equity
2007	5,45%	13,22%	6,53%	20%	80%
2009	5,70%	11,90%	8,25%	20%	80%

Risk-free – Polish Government bond from 6/10/06 until 25/10/17

Return of the market – MSCI Europe index

Firm	D	E	D/E	Beta eq. 07	Beta eq. 09
Metro	55,24%	44,76%	123,41%	0,94	0,88
Tesco	23,67%	76,33%	31,01%	0,88	0,92
Carrefour	40,09%	59,91%	66,92%	0,77	0,76
Casino	53,42%	46,58%	114,68%	0,71	0,81
Ahold	30,24%	69,76%	43,35%	1,53	0,75
Morrison	12,85%	87,15%	14,74%	1,01	0,77
Emperia	28,80%	71,20%	40,45%	0,53	0,64

Exhibit 27 – Exchange rate between the Zloty and the Euro

	Zloty/Euro
2007	0,279
2008	0,286

Acquisition of Plus Discount by Jerónimo Martins

Teaching Note

Miguel de Noronha, nº129

June 12th, 2009

Synopsis

Since 1995 Poland has been a country where Jerónimo Martins has invested strongly, and despite the worse performance of Eurocash and Jumbo in this country, the fact is that Biedronka has been a huge success. To prove not only the strong bet on this country, but also the great achievement it has been, is the almost equal weight between the Portuguese and the Polish operations in terms of workers, sales and results by the end of 2007 .

Following this great success of Jerónimo Martins in Poland through the chain of stores Biedronka, the possibility of acquiring one of the direct competitors in the hard discount sector appeared. This competitor was Plus Discount and its owner, the German company Tengelmann, was interested in selling it due to the low success that it was achieving. This was an excellent opportunity to further strengthen the leading position in the hard discount sector.

Teaching objectives

This case can be used in a course of Mergers & Acquisitions. It introduces and discusses important factors that should be analyzed in an acquisition, not only the quantitative aspects of the valuation, but also some more qualitative questions related to the process of integration and the risks of the operation. It also gives the students a general idea of the different typical stages that an acquisition goes through. Furthermore, some insights concerning the strategy of internationalization of a firm and the process of restructure will also be given.

Suggested discussion questions

1. Why did Jerónimo Martins decide to sell its operations in the British and in the Brazilian markets, as well as Eurocash and Jumbo in the Polish market? Why did it decide to maintain Biedronka?

2. What were the main factors of success of Biedronka?

3. Considering that the acquisition of Plus is more expensive than the organic growth, why would Jerónimo Martins prefer to do it, as opposed to continuing the organic expansion of the Biedronka stores?

4. What should be the value proposed by Jerónimo Martins for Plus Discount?

5. Taking into account the change in the macroeconomic context, revaluate the value proposed for Plus Discount. Why did not the expectations about the rates of growth of the sales suffer significant changes?

Case analysis

The analysis of this case study can be organized in four main categories:

- Divestiture decision;
- Success factors of an international expansion;
- Organic growth vs. growth by acquisitions;
- Business valuation.

1. Divestiture decision

Why did Jerónimo Martins decide to sell its operations in the British and in the Brazilian markets, as well as Eurocash and Jumbo in the Polish market? Why did it decide to maintain Biedronka?

The decision to sell the operations cannot be related directly to the success they were having at the time or not. In fact this choice was a result of many circumstances that happened at the same time and created a very rough context for the firm.

At that time the world was suffering a severe crisis caused by the burst of the dot-com bubble, which led to high contractions of the economies and as a result affected the activities of the firms. Just some years before the beginning of this crisis, Jerónimo Martins decided to internationalize its operations in a very strong way. So when the crisis began, the company was highly exposed due to its presence in three different countries with five different new operations, which being in a launching phase were still presenting modest results. This fact was an extremely high financial burden for Jerónimo Martins and was affecting the company in a very significant way. On top of that was the contraction of the results of the firm in Portugal in consequence of the financial crisis.

All these facts led to very serious financial problems at Jerónimo Martins that culminated with its inability to pay the interest of its debt. Therefore, the company decided to restructure the Group and refocus on a reduced number of businesses, which implied the sale of some of its operations, preferably the international ones that by being in an initial phase were consuming more financial resources than the already existing ones. This sale produced immediately a very important amount of cash-flow that was fundamental to solve the mentioned financial problems.

"…A sell-off produces the immediate benefits of an infusion of cash from the sale. The selling firm is selling a long-term asset, which generated a certain cash-flow per period, in exchange for a larger payment in the short-run. Companies that are under financial duress are often forced to sell off valuable assets to enhance cash-flows…" [1].

The decision to maintain Biedronka can be simply justified by two reasons. The first one is the fact that among all five international operations, this was the one that was already showing better results, together with better perspectives for the future, created by not only the excellent economic perspectives for Poland, but also because the discount format seemed to be the one with better conditions to succeed. The second was that the sale of the other four operations was enough to solve the financial problems, making it unnecessary to also sell Biedronka.

In conclusion, we cannot say that the decision to sell these operations was due to bad results or bad perspectives for them. It can be better justified by the need that Jerónimo Martins had at the time to reorganize its structure and to reduce the total number of operations it had, and by the urgency of an important cash inflow that could solve its very serious financial problems.

2. Success factors of an international expansion

What were the main factors of success of Biedronka?

There are several factors that contributed to the success of Biedronka, some related to the characteristics of the Polish market, and others to the strategic decisions of Jerónimo Martins.

The first factor is related to the specific conditions of Poland, which highly favoured the success of a discount format such as Biedronka. In this country salaries are low, so the price is the primary concern and the most decisive factor for the Polish when deciding where to go shopping for their groceries. Besides that, their houses and kitchens are very small and therefore, due to this lack of space the Polish are not able to go to a super or hypermarket and buy the groceries they need for one or two weeks, instead they have to go shopping more frequently during that time, preferably somewhere near home. This preference is further accentuated by the small number of existing cars. Biedronka with its relatively small stores, 500 sqm in average, is capable of launching stores in the middle of the urban centers and very close to their customers, so the problem mentioned above is in fact an advantage when compared to the competitors with other formats.

The pace at which Biedronka was able to open new stores was extremely important. The launching of 800 stores in ten years was fundamental to obtain a significant advantage in terms of scale over the competitors in the hard discount sector, Lidl, Netto and Plus Discount, which in the same period and all together opened around 600 stores. By being able to have a high number of stores, the firm is capable of achieving a high level of scale efficiency through economies of scale. This high number of stores is also very significant in the relation with the suppliers, since it gives the company a much higher bargaining power than a similar firm but with a lower number of stores. These two aspects are very important for the reduction of the general level of costs, which is vital to give the firm the possibility to practice lower prices than the competition. This is essential in the discount format where the price is the most valuable factor for the consumer.

Another important factor was the timing of entry in the Polish market. When Jerónimo Martins expanded its operations to Poland there were several other firms that were doing the same. So despite not taking advantage of being a first-mover, it managed to benefit from the fact that it was starting its operations at the same time as the competition. If the operations had begun some years later, it is probable that the implementation and the success of Biedronka could have been more difficult, due to the existence of other brands over a longer period of time.

An additional factor was the strategy of communication that was very effective in the contact with the consumer, and in the transmission of the message of the lower prices practiced by Biedronka. With the slogan *"everyday low prices"* and other publicity campaigns, the firm has won some important Polish brand awards and is also an unquestionable leader as far as brand recognition is concerned. In surveys carried out on the Polish consumers it was confirmed that the brand Biedronka was by far considered to be the most recognized in the retail market.

3. Organic growth vs. growth by acquisitions

Considering that the acquisition of Plus is more expensive than the organic growth, why would Jerónimo Martins prefer to do it, as opposed to continuing the organic expansion of the Biedronka stores?

There are two main reasons to make an acquisition. The first one is always present and is related to the value that the target firm will add to the acquirer, as well as the strategic benefits that the acquisition will bring, such as, less competition and a higher level of consolidation in the market. The second one is associated to the possibility of the target company to be acquired by a competitor. In this case the firm decides to make the acquisition not only because it will add value, but also to avoid the acquisition by a competitor. In the acquisition of Plus these two reasons are present and can be used to justify this operation.

If one of the competitors of Biedronka acquires the chain of supermarkets Plus Discount, it will immediately add 210 stores and 150 thousand square meters to its chain. This could threaten the dominant position of Jerónimo Martins in the Polish market, since the competitor would instantly approach Biedronka in the area of sales and potentially in the number of clients and sales. This fact gains even more importance in a retail market such as the Polish one, where the degree of competition is very high. If Biedronka ignores this opportunity, it may suffer in the future with a stronger competitor that could put more pressure on its position. "… *As the company grows slowly through internal expansion, competitors may respond quickly and take market share. Advantages that a company may have can dissipate over time or be whittled away by the actions of the competitors…" [1].*

Furthermore, we also have to highlight reasons that are connected to the value of Plus Discount. The previous argument applied to the competitors of Jerónimo Martins in Poland can also be used for Biedronka. If it moves towards the acquisition, it will add an important area of sales to its already significant chain of stores, so it would distance itself even more from the competition. We also have to consider that acquiring the stores instead of building them, despite being more costly, is much quicker. *"…One of the most fundamental motives for mergers and acquisitions is growth. Companies seeking to expand are faced with a choice between internal growth and growth through mergers and acquisitions. Internal growth may be a slow and uncertain process. Growth through mergers and acquisitions may be a much more rapid process…" [1].*

With the acquisition, Biedronka has the almost immediate possibility of integrating the new stores into the old ones, and with that generating synergies that could amount to higher sales than the ones registered when the stores were property of Plus. This means that the potential of these stores can be higher when they are considered to be part of the chain of Biedronka. So when evaluating the situation, we must consider that the value added by Biedronka to the new stores is much higher than the one added by the competitors.

It is also very important to mention the importance of the synergies. With this acquisition Biedronka is capable of achieving synergies at the level of procurement, marketing and logistics, which will have a significant impact in the existing stores by raising sales and increasing their margins.

Finally, another extremely important aspect is the possibility of eliminating one competitor. This would imply a higher degree of consolidation in the Polish retail market, which can allow for higher price stability and consequently better profit margins.

4. Business valuation

What should be the value proposed by Jerónimo Martins for Plus Discount?

In order to reach a value for the chain Plus Discount, it is recommended the use of the Discounted Cash Flow approach: *"…Enterprise DCF remains the favorite of many practitioners and academics because it relies solely on the flow of cash in and out of the company, rather than on accounting-based earnings (which can be misleading)…" [2]*. However, to use this method for this case, several assumptions about the future cash-flows of the firm must be made, like for example the growing rate of the sales per square meter, the EBITDA margins and the capital expenses for restructuring the stores, among others. Furthermore, there is also the need to compute a rate to discount the future cash-flows. To do this we must follow the weighted average cost of capital method: *"…WACC based-models work best when a company maintains a relatively stable debt-to-value ratio…" [2]*, as it is going to be showed later, this is clearly the case of Jerónimo Martins.

In the first step of the valuation we have to predict the rates of growth of both the sales per square meter and the EBITDA margin, not only for the Plus stores but also for the ones of Biedronka. We do this using past information related with these two topics and the predictions made by Jerónimo Martins and other institutions. The high levels of growth that the stores of Biedronka are expected to achieve in the next ten years (Exhibit 1 of the teaching note) can be explained by several factors. The first one is the strong expectations of growth of the Polish economy, already explained in the case. The second one is related with the low level of consolidation of the Polish retail market, which represents an opportunity for further organic expansion and also consolidation for Biedronka. Also important are the expectations of the Poland market research that predicts that until 2011 the Polish grocery retail market will grow around 6%. Finally, the fact that 80% percent of sales of Biedronka are of food, imply a stable growth for the future without great oscillations. For the EBITDA margin it is expected that in 2011 it will reach the 6.5% level, and that it will remain forever around this number.

The expectations of Jerónimo Martins is that in three years the Plus stores will be able to reach an operational value similar to the ones of Biedronka, consequently, and as we can see in exhibit one, in 2011 these stores will already have the same values for the sales per sqm and for the EBITDA margin. It is also important to mention that during the year of 2008, it will be very difficult for the Plus stores to be operating under the Biedronka brand, since the decision of the Polish competition authority will take some considerable time, and also the restructuring of the stores will as well last for a while. So it can be predicted that for 2008 the Plus stores will not produce any income for Jerónimo Martins.

Free cash-flow

To achieve the value of the free cash-flow from the stores we have to compute their net income, add the value of the depreciation and subtract the capital expenditures and the net working capital. All the computations mentioned to obtain the free cash-flow will be demonstrated in exhibit 2.

In the computation of the net income the first thing to do is to calculate the total sales per store, which is done simply by multiplying the sales per square meter of each year by the average size of the Plus stores that is 700 sqm. Then we have to multiply the value by the EBITDA margin, in order to get the EBITDA for each store. To reach the value of EBIT we need to subtract the value of depreciation, which is assumed to be 2% of sales per store every year. Finally, by subtracting the value of taxes of 19% we get the net income in Zlotys.

In the next step the value of the depreciation must be added back to the net income. For the capital expenditures there are three different aspects. The first one is the capital spent on the restructuring of the Plus stores into Biedronka, which is 600 thousand zlotys for each one. The second aspect is the 2 million zlotys per store necessary to revamp the stores in every 7 years. By discounting these expenses with the WACC discount rate we get, in the end of 2008, the total showed in exhibit 3. The final element of the capex is the annual capital expenses necessary to maintain the capacity of the stores, which are 600 thousand zlotys per year. Finally, to reach the value of the free cash-flow, it is necessary to subtract the changes in the net working capital. Since Biedronka is in a particular industry were the cash cycle is negative and assuming that the average inventory period (22 days), the receivables period (5.5 days) and the payable period (68 days) will remain constant, the value of the changes in the net working capital will always remain negative and will vary according with the rate of growth of sales (exhibit 4).

Now that we have obtained the free cash-flow from 2009 until 2017, we need to compute the terminal value, which will have a perpetual growth of 2.5%. This rate is justified essentially by the great potential of the Polish economy and by the specificities of the Polish retail market that are very promising.

Furthermore, to reach the present value for each year, all the values of the free cash-flow in zlotys have to be discounted with the WACC discount rate. By adding all these present values we reach the total value of one typical store. After that, this value has to be multiplied by the total number of stores of Plus Discount that will be integrated. This number will not be 210 stores, due to the restrictions of the Polish authority of competition that will impose the sale 25 stores. To conclude, the total value of the free cash-flow has to be multiplied by the spot exchange rate from the zloty to the euro in the end of 2007.

Synergies

In the next step of the valuation we have to calculate the synergies of this operation. As explained in the case, the main synergy obtained with this acquisition is related with the increase of scale of the whole operation of Biedronka, which gives significant economies of scale that are very important to reduce the costs and increase the EBITDA margins. To measure the synergies we have to compare what would be the years of 2009 and 2010, with and without the Plus stores. With the Plus stores the EBITDA margins would rise to 7 and 6.8% in 2009 and 2010 respectively, but without the stores they would be 6.25 and 6.35%. According to the expectations of Jerónimo Martins, from 2011 the EBITDA margin would be 6.5% for both cases. This variation in the margins has a significant impact in the free cash-flow of the 1100 stores that are estimated to exist in the beginning of 2009. Thus, we can estimate the synergies of the operation by computing the difference in free cash-flow of both scenarios. As shown in exhibit 5, the computations are similar to the ones in exhibit 2, being the only differences the average size store that is 520 sqm and the changes in the net working capital. The final value of the synergies is 28.7 million Euros.

Loss in the Biedronka stores

Another important aspect in the valuation is the loss in the Biedronka stores that by imposition of the Polish competition authority have to be sold. The expectation is that 15 stores will have to be disposed, so we have to include in the valuation the loss in the free cash-flow of each store. In exhibit 6 we can find this calculation.

Other elements

To conclude the valuation there are other elements that should be included. On the side of the revenues there is the cash-in provided by the sale of the Plus and Biedronka stores imposed by the Polish authority of competition, which is estimated to be around 15 million Euros. On the side of the expenses we also have to take into account 10 million zlotys in costs of non-recurrent nature, which among others will include the compensations paid to the Plus workers whose contracts will be terminated. There is also 1 million Euros for possible contingencies related to the Plus activities that may appear in the future. All these elements will be assumed to happen in the end of 2008, so they must be discounted.

In exhibit 7 we can find all the computations mentioned above that lead to the final value of Plus Discount chain of stores of 226.6 million Euros.

Taking into account the change in the macroeconomic context, revaluate the value proposed for Plus Discount. Why did not the expectations about the rates of growth of the sales suffer significant changes?

Despite the drastic change in the macroeconomic context from the end of 2007 to the beginning of 2009, it is not expected significant changes in the forecasts made for the growth of the sales per sqm and for the EBITDA margins. This is justified by the defensive portfolio of sales of Biedronka, which are composed by 80% of food, and also by the fact that it is a chain that operates exclusively in the hard discount format. This fact turns the economic crisis into an opportunity to offset a possible decline in the average basket consumed by a client, with an increasing number of clients captured from other competitors that operate in formats like the hyper or the supermarket.

As a consequence, the expectations about the rates of growth remain unchanged. The only changes happen in the sales per sqm achieved in 2008 by Biedronka, which are not as high as expected in the end of 2007, and in the rate of growth of the Plus stores sales in 2009 and 2010. All these values are present in exhibit 8.

In order to make the valuation in the beginning of 2009, we have to do the same steps as in question 4, but this time the exchange rate and the discount rate will be different due to the mentioned macroeconomic changes. However, the exchange rate used now will not be the nominal spot rate, it is necessary to make an adjustment in order for the rate to reflect the differences between the levels of inflation in both countries during the year of 2008. To do this the relative purchase parity power must be applied. So using this formula, $S_{Z/€}08 = S_{Z/€}07 * \frac{1+infl_{Pol}}{1+infl_{Port}}$, we reach the real exchange rate between the zloty and the euro in the end of 2008.

In the first step things are done exactly the same way, being the only differences the changes in the rates of growth of the first years, the discount rate and the exchange rate. These same changes must also be applied to the synergies and to the loss in Biedronka stores. For all the other elements of the valuation the modifications are only related to the discount rate. From exhibit 8 to 12 we can observe all these computations.

Finally, in exhibit 13 we find all the elements of the valuation together and the enterprise value of 284 million Euros. This value is significantly higher than the one for the end of 2007, which is mainly justified by the real appreciation of the zloty against the euro and also by the decrease of the discount rate.

Exhibit 1 – Sales per sqm & EBITDA margins

Sales per sqm (zloty)	2003	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	13.400	14.500	14.900	16.100	18.600	21.204	22.688	24.276	25.733	27.020	28.100	29.225	30.393	31.609	32.399
Variation	-	8,21%	2,76%	8,05%	15,53%	14,00%	7,00%	7,00%	6,00%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%
Plus	12.817	13.252	12.173	10.348	10.926	-	15.898	21.462	25.733	27.020	28.100	29.224	30.393	31.609	32.399
Variation	-	3,40%	-8,15%	-14,99%	5,59%	-	45,50%	35,00%	19,90%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%

EBITDA Margin	2004	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	4,90%	5,10%	5,35%	5,90%	6,10%	7,00%	6,80%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%
Plus	-	-	-	-	-	4,50%	5,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%

Exhibit 2 - Total FCF of the stores

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	Terminal value
Sales per store (zlotys)	-	11.128.411	15.023.355	18.013.003	18.913.653	19.670.199	20.457.007	21.275.287	22.126.298	22.679.456	
EBITDA	-	500.778	826.285	1.170.845	1.229.387	1.278.563	1.329.705	1.382.894	1.438.209	1.474.165	
Depreciation	-	222.568	300.467	360.260	378.273	393.404	409.140	425.506	442.526	453.589	
EBIT	-	278.210	525.817	810.585	851.114	885.159	920.565	957.388	995.683	1.020.576	
Taxes	-	52.860	99.905	154.011	161.712	168.180	174.907	181.904	189.180	193.909	
Net income	-	225.350	425.912	656.574	689.403	716.979	745.658	775.484	806.504	826.666	
Depreciation	-	222.568	300.467	360.260	378.273	393.404	409.140	425.506	442.526	453.589	
Capex	2.679.849	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	
Changes in NWC	-	-400.000	-300.000	-160.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000	
FCF	-2.679.849	247.919	426.379	576.834	517.676	545.383	589.798	635.990	684.030	700.255	9.462.245
PV FCF	-2.434.334	204.573	319.599	392.762	320.189	306.422	301.017	294.855	288.073	267.888	3.619.860
Tot. FCF	3.880.905										
Tot. FCF stores	717.967.415										
Tot. FCF stores (euros)	200.097.518										

Exhibit 3 – Capex Revamping (zlotys)

	2015	2022	2029	2036	2043	2050	2057	2064	2071
Capex Revamping	188.838.264	96.378.081	49.188.837	25.104.688	12.812.772	6.539.302	3.337.488	1.703.366	869.353
Total	384.772.151								

Exhibit 4 – Changes in NWC (zlotys)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Changes in NWC	-400.000	-300.000	-160.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000

Exhibit 5 - Synergies

With Plus	2009	2010
Sales per sqm (zlotys)	22.688	24.276
EBITDA margin	7,00%	6,80%
Sales per store	11.797.906	12.623.759
EBITDA	825.853	858.416
Depreciation	235.958	252.475
EBIT	589.895	605.940
Taxes	112.080	115.129
Net income	477.815	490.812
Depreciation	235.958	252.475
Capex	600.000	600.000
Changes in NWC	-80.000	-80.000
FCF	193.773	223.287
PV FCF	159.894	167.368
Tot. FCF	327.263	
Tot. FCF stores	359.988.764	
Tot. FCF stores (euros)	100.328.869	

Without Plus	2009	2010
Sales per sqm (zlotys)	22.688	24.276
EBITDA margin	6,25%	6,35%
Sales per store	11.797.906	12.623.759
EBITDA	737.369	801.609
Depreciation	235.958	252.475
EBIT	501.411	549.134
Taxes	95.268	104.335
Net income	406.143	444.798
Depreciation	235.958	252.475
Capex	600.000	600.000
Changes in NWC	-80.000	-80.000
FCF	122.101	177.273
PV FCF	100.753	132.878
Tot. FCF	233.631	
Tot. FCF stores	256.994.158	
Tot. FCF stores (euros)	71.624.272	

Exhibit 6 – Loss in Biedronka stores

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Terminal Value
Sales per store (zlotys)	-	11.797.906	12.623.759	13.381.185	14.050.244	14.612.254	15.196.744	15.804.613	16.436.798	16.847.718	
EBITDA	-	825.853	858.416	869.777	913.266	949.796	987.788	1.027.300	1.068.392	1.095.102	
Depreciation	-	235.958	252.475	267.624	281.005	292.245	303.935	316.092	328.736	336.954	
EBIT	-	589.895	605.940	602.153	632.261	657.551	683.853	711.208	739.656	758.147	
Taxes	-	112.080	115.129	114.409	120.130	124.935	129.932	135.129	140.535	144.048	
Net income	-	477.815	490.812	487.744	512.131	532.617	553.921	576.078	599.121	614.099	
Dep	-	235.958	252.475	267.624	281.005	292.245	303.935	316.092	328.736	336.954	
Capex	2.079.849	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	
Changes in NWC	-	-80.000	-80.000	-65.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000	
FCF	-2.079.849	193.773	223.287	220.368	243.136	259.862	292.856	327.170	362.857	371.054	5.013.887
PV FCF	-1.889.303	159.894	167.368	150.047	150.383	146.003	149.466	151.681	152.814	141.950	1.918.104
Tot. FCF	1.398.407										
Tot. FCF stores	20.976.102										
Tot. FCF stores (euros)	5.846.040										

Exhibit 7 – Enterprise Value

	FCF stores	Synergies	Cash-in disposals	Costs of non-recurrent nature	Loss in Biedronka stores	Contingencies
	200.097.518	28.704.597	13.625.769	9.083.846	5.846.040	908.385
Enterprise Value	226.589.614					

Exhibit 8 – Sales per sqm and EBITDA margins 2009

Sales per sqm (Zloty)	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	20.800	22.256	23.814	25.243	26.505	27.565	28.668	29.814	31.007	31.782
Variation	12,00%	7,00%	7,00%	6,00%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%
Plus	-	15.297	21.110	25.243	26.505	27.565	28.668	29.814	31.007	31.782
Variation	-	40,00%	38,00%	19,58%	5,00%	4,00%	4,00%	4,00%	4,00%	2,50%

EBITDA margin estimatives	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Biedronka	6,10%	7,00%	6,80%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%
Plus	-	4,50%	5,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%	6,50%

Exhibit 9 - Total FCF of the stores 2009

	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	Terminal value
Sales per store	-	10.707.749	14.776.694	17.669.971	18.553.470	19.295.608	20.067.433	20.870.130	21.704.935	22.247.558	
EBITDA	-	481.849	812.718	1.148.548	1.205.976	1.254.215	1.304.383	1.356.558	1.410.821	1.446.091	
Depreciation	-	214.155	295.534	353.399	371.069	385.912	401.349	417.403	434.099	444.951	
EBIT	-	267.694	517.184	795.149	834.906	868.302	903.034	939.156	976.722	1.001.140	
Taxes	-	50.862	98.265	151.078	158.632	164.977	171.577	178.440	185.577	190.217	
Net income	-	216.832	418.919	644.070	676.274	703.325	731.458	760.716	791.145	810.924	
Depreciation	-	214.155	295.534	353.399	371.069	385.912	401.349	417.403	434.099	444.951	
Capex	2.983.374	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	
Changes in NWC	-	-400.000	-300.000	-160.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000	
FCF	-2.983.374	230.987	414.453	557.470	497.343	524.237	567.807	613.119	660.244	675.875	10.553.641
PV NFCF	-2.983.374	211.790	348.426	429.708	351.501	339.715	337.369	334.016	329.795	309.544	4.833.472
Tot. NFCF	4.841.961										
Tot. NFCF stores	895.762.745										
Tot. NFCF stores (euros)	255.840.770										

Exhibit 10 – Capex Revamping 2009 (zlotys)

	2015	2022	2029	2036	2043	2050	2057	2064	2071
Capex Revamping	201.568.985	109.810.962	59.822.930	32.590.398	17.754.631	9.672.386	5.269.333	2.870.633	1.563.866
Total	440.924.123								

Exhibit 11 – Synergies 2009

With Plus	2009E	2010E
Sales per sqm	22.256	23.814
EBITDA margin	7,00%	6,80%
Sales per store	11.573.120	12.383.238
EBITDA	810.118	842.060
Depreciation	231.462	247.665
EBIT	578.656	594.395
Taxes	109.945	112.935
Net income	468.711	481.460
Depreciation	231.462	247.665
Capex	600.000	600.000
Changes in NWC	-80.000	-80.000
FCF	180.174	209.125
PV FCF	165.200	175.809
Tot. FCF	341.009	
Tot. FCF stores	375.109.389	
Tot. FCF stores (euros)	107.135.819	

Without Plus	2009E	2010E
Sales per sqm	22.256	23.814
EBITDA margin	6,25%	6,35%
Sales per store	11.573.120	12.383.238
EBITDA	723.320	786.336
Dep	231.462	247.665
EBIT	491.858	538.671
Taxes	93.453	102.347
Net income	398.405	436.323
Depreciation	231.462	247.665
Capex	600.000	600.000
Changes in NWC	-80.000	-80.000,00
FCF	109.867	163.988,17
PV FCF	100.736	137.863
Tot. FCF	238.599	
Tot. FCF stores	262.458.834	
Tot. FCF stores (euros)	74.961.446	

Exhibit 12 – Loss in Biedronka Stores 2009

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Terminal Value
Sales per store		11.797.906	12.623.759	13.381.185	14.050.244	14.612.254	15.196.744	15.804.613	16.436.798	16.847.718	
EBITDA		825.853	858.416	869.777	913.266	949.796	987.788	1.027.300	1.068.392	1.095.102	
Depreciation		235.958	252.475	267.624	281.005	292.245	303.935	316.092	328.736	336.954	
EBIT		589.895	605.940	602.153	632.261	657.551	683.853	711.208	739.656	758.147	
Taxes		112.080	115.129	114.409	120.130	124.935	129.932	135.129	140.535	144.048	
Net income		477.815	490.812	487.744	512.131	532.617	553.921	576.078	599.121	614.099	
Depreciation		235.958	252.475	267.624	281.005	292.245	303.935	316.092	328.736	336.954	
Capex	2.383.374	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	600.000	
Changes in NWC	-	-80.000	-80.000	-65.000	-50.000	-35.000	-35.000	-35.000	-35.000	-20.000	
FCF	-2.383.374	193.773	223.287	220.368	243.136	259.862	292.856	327.170	362.857	371.054	5.793.925
PV FCF	-2.383.374	177.669	187.715	169.864	171.838	168.395	174.004	178.236	181.249	169.939	2.653.565
Tot. FCF	1.849.100										
Tot. FCF stores	27.736.498										
Tot. FCF stores (euros)	7.921.882										

Exhibit 13 – Enterprise value 2009

	FCF stores	Synergies	Cash-in disposals	Costs of non-recurrent nature	Loss in Biedronka stores	Contingencies
	255.840.770	32.174.373	15.000.000	10.000.000	7.921.882	1.000.000
Enterprise Value	284.093.261					

Exhibit 14 – WACC 2007 & 2009

The first step in the computation of the discount rate is the definition of the respective weights of the equity and of the debt of the company. For Jerónimo Martins the targets for the long run are 80% of equity and 20% of debt. Then, we need the values of the cost of debt and of the cost of equity. For the cost of debt we have to know the rate that Jerónimo Martins was paying for its debt in the final of 2007, which was 6.53%. For the cost of equity we have to use the CAPM model.

The inputs for this model are the risk-free, the beta of the company and the return of the market. For the risk-free we will use the Poland Government bond, because it expresses better the risk subjacent to this country. Using the Government bond beginning on the 6th of October of 2006 and maturing on the 25th of October of 2017, we can make an average of the values of the yield from October of 2006, until the end of 2007, which gives us the value for the risk-free of 5,45%. For the beta we will use an industry beta composed by the comparables presented in exhibit 15. The first step to reach the beta is to get all the equity betas of the seven companies, provided from monthly data from the end of 2002 until the end of 2007. Next by using this formula, $\beta_e = \beta_u(1 + \frac{D}{E})$, we get the beta unlevered for each firm. After that we have to make an average of those betas, and using again that formula with the capital structure of Jerónimo Martins we get a beta equity of 0.75. The return of the market is calculated from historical data of the MSCI Europe index. By making an arithmetic average of the annual returns from 1969 until 2007 of this index, we reach the value of 13.22%. Now that we have all the inputs needed for the CAPM, we just have to use the model and get the value of 11.28% for the cost of equity.

To finish we have to apply the WACC formula: $\frac{D}{V} * r_d * (1 - T) + \frac{E}{V} * r_e$, where T is the Polish tax rate of 19%. The value we get for the discount rate in the end of 2007 is 10.09%.

For the 2009 discount rate the process is exactly the same, but the date used previously must be updated in order to reflect the conditions in the beginning of this year. The cost of debt rose considerably and is now 8.25%. For the risk-free we will use the same Government bond, however now we need to include the values of the yield in the year of 2008, which gives us a new risk-free of 5.7%. The beta will also be changed to 0.64, since now the data goes from the end of 2003 to the end of 2008. For the return of the market we need to add the year of 2008 to the average made previously, so due to the really weak year of the stock markets, the value will decrease to 11.9%. Now that all the values for the WACC are available we can reach the discount rate for 2009, which is 9.06%.

Exhibit 15 – Comparables betas

Firm	D	E	D/E	Beta eq. 07	Beta unlev. 07	Beta eq. 09	Beta unlev. 09
Metro	55,24%	44,76%	123,41%	0,94	0,42	0,88	0,40
Tesco	23,67%	76,33%	31,01%	0,88	0,67	0,92	0,70
Carrefour	40,09%	59,91%	66,92%	0,77	0,46	0,76	0,46
Casino	53,42%	46,58%	114,68%	0,71	0,33	0,81	0,38
Ahold	30,24%	69,76%	43,35%	1,53	1,07	0,75	0,52
Morrison	12,85%	87,15%	14,74%	1,01	0,88	0,77	0,67
Emperia	28,80%	71,20%	40,45%	0,53	0,38	0,64	0,45

Exhibit 16 – Exchange rates

	Zloty/Euro
2007	0,279
2008	0,286

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